

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:B09 / PLR-122787-02

Date:

September 24, 2002

Re:

Legend

Decedent	=
Trust	=
Date 1	=
Date 2	=
Date 3	=
State	=
Account 1	=
Beneficiary 1	=
Beneficiary 2	=
Beneficiary 3	=
Beneficiary 4	=
Beneficiary 5	=
Beneficiary 6	=
Beneficiary 7	=
Beneficiary 8	=
Beneficiary 9	=

Beneficiary 10 =

Beneficiary 11 =

Date 4 =

Court =

Date 5 =

a =

b =

c =

Date 6 =

Dear :

This is in response to your letter dated April 9, 2002, requesting a ruling under § 2055(a) of the Internal Revenue Code, on behalf of Decedent's estate.

Decedent created Trust, a revocable trust, on Date 1. Trust was amended on Date 2. Decedent died on Date 3. At the time of Decedent's death, most of his assets were in Trust.

Article V of the Trust agreement provides that during Decedent's life, Decedent shall receive the entire net income from the Trust estate payable at least quarterly and distributions of principal as requested by Decedent or determined by the trustee to be necessary or desirable to provide for the proper health, maintenance and support of Decedent.

Article VII of the Trust agreement provides that upon Decedent's death, the Trust shall become irrevocable and the remaining Trust estate, including additions made by bequest or devise under Decedent's last will and testament, shall be held in Trust to be administered by the Successor Trustee(s) in accordance with the terms and conditions stated in Article VII.

Section 7.3 of Article VII of the Trust agreement provides for distributions from Trust after payment of debts, expenses, costs and taxes. Section 7.3.A(1) provides that Account 1 shall remain in Trust for 21 years after the death of the last beneficiary or as determined by the State statutory rule against perpetuities. Section 7.3.A(2) provides that all of the annual accumulated interest income and growth (appreciation

over original investment amount), if any, from Account 1 shall be divided into fourteen separate, but unequal shares, and shall be distributed annually, outright and in fee, as follows: 3.00 shares to Beneficiary 1, 2.50 shares to Beneficiary 2, 1.00 share to Beneficiary 3, 1.50 shares to Beneficiary 4, 0.75 share to Beneficiary 5, 0.75 share to Beneficiary 6, 0.75 share to Beneficiary 7, 0.75 share to Beneficiary 8, 1.50 shares to Beneficiary 9, 1.00 share to Beneficiary 10, 0.50 share to Beneficiary 11.

Section 7.3.A(3) provides that if any beneficiary named in this specific bequest shall be deceased at the time any annual distribution is to be made, then his or her bequest is hereby revoked, and his or her share shall be distributed outright, and in fee, as follows:

(a) Five percent of his or her share shall be distributed outright, to Beneficiary 11; the remaining 95% shall be distributed proportionally to the then living beneficiaries, outright (total surviving beneficiary shares shall be divided by the total shares in effect, then multiplied by the annual amount to be distributed to determine the annual distribution to each surviving beneficiary).

(b) Upon the death of the last surviving beneficiary, then all of the annual income and growth, if any, shall be distributed annually outright, to Beneficiary 11. Upon termination, the trustee shall distribute all of the remaining principal, accumulated interest and growth, if any, from Account 1 to Beneficiary 11. (Beneficiary 11 is a church.)

Section 7.3.B provides that all of the Decedent's cash accounts, including checking, savings, money market, etc., shall be distributed outright, to Decedent's sister, Beneficiary 1. If Beneficiary 1 is deceased at the time distribution is to be made, then her share shall be distributed outright, and in fee, to Beneficiary 3, Beneficiary 4, Beneficiary 5, Beneficiary 6, Beneficiary 7, Beneficiary 8, Beneficiary 9, and Beneficiary 10, or the then living survivor(s) of them, or to their issue, per stirpes.

Section 7.3.C provides that all of the remaining principal of and the accumulated undistributed income, if any, from Trust shall be used for the sole purpose of paying administrative costs and taxes associated with the management of the Trust estate, including those taxes and costs associated with the distribution of Account 1. Upon the termination of Trust, the trustee is to distribute all of the remaining principal of and the accumulated undistributed income, if any, to Beneficiary 11.

Prior to the Date 2 amendment, the entire remaining Trust principal and accumulated undistributed income, other than Account 1, was to be distributed in shares as follows: 55% to Beneficiary 1 and 45% to Beneficiary 2. If either beneficiary was deceased at the time of distribution, that beneficiary's share was to be distributed to Beneficiary 3, Beneficiary 4, Beneficiary 5, Beneficiary 6, Beneficiary 7, Beneficiary 8, Beneficiary 9, and Beneficiary 10, per stirpes.

On Date 4, Decedent's family members filed documents with Court challenging the changes made to Trust by the Date 2 amendment. The family members alleged that the amendment was invalid as it was prepared through undue influence. Contentious litigation ensued. The representatives of Decedent's estate represent that, under State law, if the family members' challenge had been successful, the amendment would have been nullified and the assets comprising Decedent's estate would have been distributed only to family members and none of the assets would have been distributed to Beneficiary 11.

On Date 5, the parties reached an agreement that ended the litigation. Paragraph 4 of the settlement agreement provides that \$a shall be paid to Beneficiary 1. Paragraph 5 provides that \$b shall be paid to Beneficiary 2. Paragraphs 6 through 13 provide for payments of trustee and attorney fees. Paragraph 14 provides that \$c shall be paid to Beneficiary 11. Paragraph 15 provides for the distribution of the remaining assets of Decedent's estate and Trust to the family members. Court entered a "Final Order Approving Settlement Agreement and Terminating Trust" on Date 6.

Decedent's estate has requested a ruling that the distribution to Beneficiary 11, under the terms of the settlement agreement, qualifies for the estate tax charitable deduction under § 2055.

Law and Analysis

Under § 2055(a)(2), for estate tax purposes, the value of the taxable estate shall be determined by deducting from the value of the gross estate the amount of all bequests, legacies, devises, or transfers to or for the use of any corporation organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes. A trust that qualifies under § 501(c)(3) is one that is organized and operated exclusively for these purposes.

Section 2055(e)(2) disallows the estate tax charitable deduction where an interest in property (other than an interest described in § 170(f)(3)(B)) passes or has passed from the decedent to a person, or for a use, described in § 2055(a), and an interest (other than an interest which is extinguished upon the decedent's death) in the same property passes or has passed (for less than an adequate and full consideration in money or money's worth) from the decedent to a person, or for a use, not described in § 2055(a), unless –

(A) in the case of a remainder interest, such interest is in a trust which is a charitable remainder annuity trust or a charitable remainder unitrust (described in § 664) or a pooled income fund (described in § 642(c)(5)), or

(B) in the case of any other interest, such interest is in the form of a guaranteed annuity or is a fixed percentage distributed yearly of the fair market value of the property (to be determined yearly).

In Flanagan v. United States, 810 F.2d 930 (10th Cir. 1987), the decedent created a revocable trust during his life, which provided that, upon his death, the trustees were to make certain provisions for his nieces, nephews, and an employee. The trust also provided the trustee with the discretionary authority to pay a portion of the net income or principal for his sister's care, comfort, and support during her lifetime. The residue of the trust principal and any accumulated income was to be put to use for charitable, educational, and public uses or purposes as the trustee may from time to time appoint, order or direct. The decedent's sister, together with his other intestate heirs, challenged the validity of the trust as a testamentary instrument. A settlement was reached and, under the agreement, a charity received certain specific properties. Subsequently, the decedent's estate filed its federal estate tax return claiming a charitable deduction for the value of the properties that passed to the charity. The Internal Revenue Service challenged the deduction asserting that the charitable interest was traceable to a nonqualifying split-interest trust that did not meet the requirements of § 2055(e)(2). The court held that an amount that passes outright to charity under a settlement agreement or compromise of a bona fide will contest qualifies for a charitable deduction under § 2055(a)(2). In these circumstances, there is no split-interest transfer to which § 2055(e)(2) applies and a charitable deduction under § 2055(a)(2) is allowable for the value of the property that actually passes to the charity. The court reasoned that the case involved none of the abuses of the charitable deduction that § 2055(e)(2) was enacted to eliminate because the actual amount passing to charity had been established. See also Estate of Strock v. United States, 655 F.Supp. 1334 (W.D. Pa. 1987) and Northern Trust Co. v. United States, 41 AFTR2d 78-1523 (N.D. Ill. 1977).

In Rev. Rul. 89-31, 1989-1 C.B. 277, the decedent died testate. Under his will, the decedent bequeathed the residue of the estate to a trust the terms of which provided that income was to be paid to A, an individual, for A's life and the remainder was to be paid to a charitable organization described in §§ 170(c) and 2055(a). In good faith, A challenged the validity of the will, and as a result of a settlement, the estate made an immediate payment to A and distributed the balance of the trust to the charitable organization. The revenue ruling holds that the amount paid to the charitable organization qualifies for the estate tax charitable deduction under § 2055(a).

Section 7.3 establishes a trust that provides Beneficiary 11 with an interest that does not meet the requirements of § 2055(e)(2), i.e., it is not a charitable remainder annuity trust, a charitable remainder unitrust or a pooled income fund. Therefore, the bequest to Beneficiary 11, as described in the Trust, does not qualify for the estate tax charitable deduction. However, an outright payment to a charitable organization under the terms of the settlement agreement will qualify for a charitable deduction under

§ 2055(a) if the settlement is the result of a good faith challenge and not entered into collusively by the parties to circumvent § 2055(e)(2). Rev. Rul. 89-31, supra.

In this case, there was a bona fide conflict among the parties who entered into the settlement agreement. The litigation was not entered into in a collusive manner to circumvent § 2055(e)(2). Therefore, we conclude that based on the facts and representations made, the estate is entitled to a charitable deduction under § 2055(a)(2) for \$c, the amount passing to Beneficiary 11 under the settlement among the beneficiaries of Decedent's estate.

Except as expressly provided herein, no opinion is expressed or implied concerning the federal tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings it is subject to verification on examination.

Pursuant to the Power of Attorney on file with this office, a copy of this letter is being sent to the trustee of Trust.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,

James F. Hogan

James F. Hogan
Senior Technician Reviewer
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure:

Copy of Letter for 6110 purposes